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Keeping Community at the Heart of the Community Reinvestment Act

Remarks by

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Build.Community.Power

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I want to thank Ben Dulchin and the Association of Neighborhood and Housing Development (ANHD) for inviting me to be here with you today. While New York is known globally as a cultural hub that attracts the world to its doorstep, it is known locally as a city of neighborhoods. Like other cities across this country, New York's future is bound to the vitality of its neighborhoods as places to live, work, learn, play, worship, and invest.<sup>1</sup>

Neighborhoods have been the focus of ANHD's work for over 40 years. The organization's success is a function of its unwavering focus on preserving and strengthening the quality of life in low- and moderate-income neighborhoods across the five boroughs. The mission of each of the members of ANHD is to strengthen these communities. Together, your organizations are providing capacity building, advocacy, and services for the benefit of your communities and the city as a whole.

Like many of the nation's metropolitan areas, New York City has rebounded since the recession and is thriving.<sup>2</sup> That, however, has not been the experience for many. Many of the city's residents have not fully recovered, and some have fallen further behind. Here, as elsewhere in the country, there remain important gaps in economic opportunity.

Powerful research now demonstrates that persistent gaps in economic opportunity are connected to the health of neighborhoods. The effects of place on opportunity can stretch from one generation to the next. Raj Chetty and others have shown that upward mobility can vary immensely by neighborhood even within the same metropolitan area. The longer a child lives in

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<sup>1</sup> I am grateful to Theresa Stark of the Federal Reserve Board for her assistance in preparing these remarks. The remarks represent my own views, which do not necessarily represent those of the Federal Reserve Board or the Federal Open Market Committee.

<sup>2</sup> According to the most recent report by the New York City Comptroller, the city's GDP grew 2.7 percent in the first quarter of 2018 as compared to 2.3 percent for the nation, and the unemployment rate for the city fell to 4.3 percent, the lowest rate on record. See "NYC Economic Growth Slows Down, but Still Surpasses the Nation," <https://comptroller.nyc.gov/reports/new-york-city-quarterly-economic-update/>.

a neighborhood of opportunity--a neighborhood that is racially integrated and has a strong middle class, strong family structures, more social capital, and better schools--the more likely that a child will do better than their parents economically in adulthood and navigating a path of upward mobility.<sup>3</sup>

As I have noted previously, these disparities matter for growth and prosperity. If there are large disparities in opportunity, such that enterprise, exertion, and investments reap lower returns in some communities than others, then families and small businesses in these communities will invest less in the future, and potential growth will fall short.<sup>4</sup> Although there are important implications at the national level for growth and prosperity, to the extent that the roots of the disparities in opportunity and mobility lie in local communities, an important part of the solution is likely to be investments in those communities.<sup>5</sup>

### **The Community Reinvestment Act**

That one powerful insight--the importance of investment in communities--lies at the heart of the Community Reinvestment Act (CRA). The CRA is one of the principal tools the Congress has provided for improving investment and development in lower-income communities. Implementing this law effectively is one of the important responsibilities of the banking agencies in promoting strong outcomes locally that reverberate nationally. So let me turn to the role of the CRA in supporting local efforts to strengthen low- and moderate-income neighborhoods and

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<sup>3</sup> See <http://www.equality-of-opportunity.org/>.

<sup>4</sup> See, for example, Lael Brainard, *Why Opportunity and Inclusion Matter to America's Economic Strength*, May 22, 2017, <https://www.federalreserve.gov/newsevents/speech/brainard20170522a.htm>. Studies have shown inequality is associated with lower long-term growth and with lower income growth. See, for example, Heather Boushey and Carter C. Price, *How Are Economic Inequality and Growth Connected: A Review of Recent Research* (Washington, DC: Washington Center for Equitable Growth, October 2014), <http://equitablegrowth.org/wp-content/uploads/2014/10/100914-ineq-growth.pdf>.

<sup>5</sup> See Raj Chetty <https://www.citylab.com/equity/2017/10/to-revive-the-american-dream-take-a-neighborhood-precision-approach/543630/>.

offer my preliminary thoughts on the opportunity before us to make the regulations even more effective in this regard.

The CRA was enacted in 1977 to combat the legacy of redlining--literally, the demarcation in red ink of neighborhoods deemed too risky for lending. Federal lending agencies used these redlined maps in deciding where to guarantee mortgage loans.<sup>6</sup> Not surprisingly, the resulting deprivation of credit stifled opportunity for the people living in these areas.

Through the CRA, Congress requires the federal banking agencies to encourage banks and thrifts to help meet the credit needs of the communities they are chartered to serve, including low- and moderate-income neighborhoods, consistent with safety and soundness. It requires the Federal Reserve and other agencies to evaluate how well banking institutions help meet those needs and to assign ratings to their performance.<sup>7</sup> The CRA further requires the agencies to make public both the ratings and their written evaluations of the banks' performance. This transparency provides an incentive for banks to work with their communities to meet the needs of low- and moderate-income members and provides important information to enable community members to engage meaningfully with banks.

Research has demonstrated that the CRA has had a positive effect on low- and moderate-income neighborhoods.<sup>8</sup> The CRA is unique in that it puts decisionmaking about the

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<sup>6</sup> See <http://news.nationalgeographic.com/2016/10/housing-discrimination-redlining-maps/> for details about how maps created by the Home Owners' Loan Corporation in the 1930s were used to designate areas considered hazardous for mortgage lending and influenced whether mortgage loans qualified for government guarantees from the Federal Housing Administration. To view interactive historical maps, see <https://dsl.richmond.edu/panorama/redlining/#loc=10/44.1788/-84.8433&opacity=0.8>.

<sup>7</sup> See 12 U.S.C. § 2901; the ratings are Outstanding, Satisfactory, Needs to Improve, and Substantial Non-compliance.

<sup>8</sup> CRA-related mortgage loans had delinquency rates lower than the average across all 2006-vintage mortgages and sharply lower than those of subprime loans; see Neil Bhutta, and Glenn B. Canner, "Mortgage Market Conditions and Borrower Outcomes: Evidence from the 2012 HMDA Data and Matched HMDA-Credit Record Data," *Federal Reserve Bulletin* 99 (November 2013). In addition, a study of mortgage loans originated between 2003 and 2006 as part of a CRA targeted, low- to moderate-income homebuyer program found that they performed nearly as well as

community's needs and priorities in the hands of local stakeholders: financial institutions that lend and invest, community organizations that deliver services and develop real estate, and state and local governments that direct incentives and subsidies. The enactment of other laws around the same time supported the CRA's success, including the Home Mortgage Disclosure Act, which requires lenders to report the location of their home mortgage lending and the race and income of borrowers.

Much has changed in the years since the CRA was enacted, including technology-driven changes in the delivery of financial services, and it is high time to consider corresponding improvements to the regulations. Both banks and community organizations have offered a variety of suggestions for improving the CRA regulations and their implementation in the last several years. We are undertaking discussions with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, with which we have traditionally issued joint rulemakings on the CRA. The Federal Reserve has long been interested in engaging in an interagency review of the CRA regulations, so we are pleased to participate in this process. In addition, the Treasury Department recently completed an extensive outreach effort related to modernizing the CRA regulations.

CRA is a vital tool to address the credit needs of low- and moderate-income communities, and I believe the time is ripe for a refresh to make it even more relevant to today's challenges. There are five principles that can help guide our efforts.

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prime loans and much better than subprime mortgage loans through the financial crisis; see Lei Ding, Roberto G. Quercia, Janneke Ratcliffe, and Wei Lei, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," *Journal of Real Estate Research* 33 no. 2 (2011): 245–77. Another analysis found evidence of a substantial increase in mortgage lending due to the CRA--especially among low-income borrowers--with no measurable rise in the likelihood of default; see Daniel Ringo, "Mortgage Lending, Default, and the Community Reinvestment Act," June 15, 2017.

## **The Importance of Place**

First, we should update the area in which the agencies assess a bank's CRA activities while retaining the core focus on place. This is the most important aspect of refreshing the CRA, and also the one that will require the most care. As our Federal Advisory Council noted, "...a bank's ability to engage in meaningful community development efforts continues to require a meaningful knowledge of and presence in local communities."<sup>9</sup> A significant strength of CRA evaluations is that a bank's performance is evaluated taking into account the demographics of its communities, the types of housing and businesses they serve, and the other financial institutions serving those communities.

The current regulations use branches and deposit-taking ATMs as a proxy for the communities the bank serves because these were the primary mechanisms for delivering services when the CRA was enacted and for many years subsequently. This reflected an environment where interstate banking was not allowed, and physical branches were necessary for deposit taking and lending. Today, changes in technology and consumer preferences have made it possible for banks to serve customers far beyond their physical branches and deposit-taking ATMs--via online and mobile platforms.

Even so, as much as technology has made banking transactions more convenient for customers, it has not eliminated the need for branches. For large parts of the country, branches and deposit-taking ATMs remain an important way that banks engage with a community. Branches and ATMs are still necessary for depositing and withdrawing cash. Branches also provide personal service and assistance to consumers and business customers. They provide a

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<sup>9</sup> Federal Reserve Board Federal Advisory Council, Record of Meeting, May 2018, <https://www.federalreserve.gov/aboutthefed/files/fac-20180511.pdf>.

presence for lenders to get to know borrowers and the communities in which they live, lend, and invest. As our Community Advisory Council recently emphasized, “[f]or many rural and LMI populations, bank branches remain critical for the provision of bank loans, investments, and services.”<sup>10</sup>

Recent studies measuring the impact of branch closures on credit availability in neighborhoods demonstrate that branches still matter, particularly with respect to accessing small business credit.<sup>11</sup> The Federal Reserve Bank of New York found that access to small business credit declines and the rates for small business loans increase as the distance between the bank and the borrower grows.<sup>12</sup> Similarly, the large majority of mortgage lending continues to be located in one or more of a bank’s delineated assessment areas--that is, near a physical branch.

This research also found that people in low-income census tracts were more than twice as likely to live in a banking desert--an area without a branch within 10 miles--than those in higher-income tracts.<sup>13</sup> When they are cut off from mainstream banking institutions, some consumers rely on more expensive alternatives that include payday loans, auto title loans, pawn shops, and check cashing services.

Banks vary widely in terms of the types of services they offer and the mechanisms they use for reaching their customers. On one end of the spectrum, many community banks still rely

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<sup>10</sup> Federal Reserve Board Community Advisory Council, Record of Meeting, May 4, 2018, <https://www.federalreserve.gov/aboutthefed/files/cac-20180504.pdf>.

<sup>11</sup> See Hoai-Luu Q. Nguyen, *Do Bank Branches Still Matter? The Effect of Closings on Local Economic Outcomes*, October 2015. The reason is the information-intensive nature of the underwriting process. Even in areas with plenty of bank branches, declines in small businesses lending because of the loss of the relationship between a small business owner and their loan officer were significant. Once broken, the study found that those relationships take years to replace. The impact of branch closures were found to be more severe in tracts with lower median income, a higher fraction of minority households, and where firms were, on average, closer to their lending.

<sup>12</sup> Donald Morgan, Maxim Pinkovskiy, and Bryan Yang, “Banking Deserts, Branch Closings and Soft Information,” *Liberty Street Economics* blog, March 7, 2015, <http://libertystreeteconomics.newyorkfed.org/2016/03/banking-deserts-branch-closings-and-soft-information.html>.

<sup>13</sup> See, again, Morgan, Pinkovskiy, and Yang, March 7, 2015; between 2009 and 2014, the fraction of low-income tracts that were also banking deserts increased 0.17 percentage points compared to a 0.06 percentage point increase in higher-income tracts.

primarily on branches and ATMs to reach their customers, with mobile functionality offered primarily to enhance the customer experience. In the middle of the spectrum, regional and national banking organizations are using online and mobile app capabilities to attract and retain customers well beyond their physical footprint. At the other end of the spectrum, online banks employ business models that reach customers across much or all of America without relying on branches. Although these online banks may provide the same retail products and services as a traditional bank with a branch network, because they have only one location, they are evaluated for CRA purposes in the area around that location, rather than in the many areas where they have customers.

Still other banks offer a limited set of credit products or wholesale services. Take, for instance, the example of Industrial Loan Companies (ILCs), which have CRA obligations as state-chartered insured depository institutions. ILCs are owned by corporations rather than bank holding companies and are typically chartered to provide credit cards or other forms of financing related to their parent company's business. Many large ILCs are chartered in Utah and are evaluated on their CRA performance in Salt Lake City, even though they lend nationally. The result is a saturated market for community development lending and investment in Salt Lake City. At the same time, other areas in Utah and beyond have important community development opportunities that may go unmet. At a minimum, revised CRA regulations should allow banks with this type of business model to expand CRA activities beyond the area surrounding its branch so that the community and economic development needs of more underserved communities can be met.

Branches are important vehicles for reaching small business customers and low-income consumers, but they are not the only way. In considering ways to revise the CRA regulations,



the agencies should be thoughtful about how to make the areas in which we evaluate CRA performance more meaningful to both banks and low- and moderate-income communities. For community banks that rely on branches to serve their customers, the current assessment area approach may need only small adjustments. For banks that serve their customers through a variety of approaches, assessing their broader deposit-taking and loan-making footprint might make sense. For large wholesale banks, it might make sense to evaluate CRA activity in a broader area and to encourage them to spread their investments and services to underserved areas.

The CRA regulations should be updated in a way that is appropriate for different business models. To the extent that banks are able to serve the needs in low- and moderate-income communities through additional channels, it is important they receive due consideration, while CRA revisions should also continue to recognize the importance of sustaining branches in communities where they are needed.

### **Opportunities in Underserved Areas**

The second, and related, principle guiding our CRA refresh is that the regulations should encourage banks to seek out opportunities in underserved areas. As I noted earlier, the CRA recognizes that banks make a unique contribution. Banks are able to make targeted and valuable investments because of their stake in the local community and their knowledge of it. As a long-term stakeholder in a community, a bank's efforts to finance housing, small businesses, and community services are not just good business short-term, but also good investments long-term as residents improve their economic standing and use more banking services. Streamlining the CRA regulations and clarifying the performance measures could create stronger incentives for

banks to pursue the less obvious, but potentially more impactful, projects that low- and moderate-income neighborhoods need the most to become areas of opportunity.

We will want to update the CRA in ways that reduce the distortions that lead to some areas becoming credit “hot spots” and others credit deserts. Where there is a high density of banks relative to investment opportunities, the result of too many banks competing for too few CRA-qualified investments can be declining returns. Meanwhile, other areas have a difficult time attracting capital not because the social return on investment is low, but rather because they are not in a bank’s major market, if they are served by a bank at all. However we define a bank’s assessment areas in the future, the regulations need to be designed and implemented in a way that encourages banks to direct their community investment activities productively.

### **Tailoring**

The third guiding principle is that the CRA regulations should be tailored to banks of different sizes and business models. We should set standards that are flexible enough to evaluate the CRA performance of a \$100 million bank no less effectively than a \$2 trillion bank. Banks seek clearer, simpler rules that result in more CRA activity with less burden. We believe this can be done while retaining the flexibility to evaluate a bank’s CRA performance in light of its size, business model, capacity, and constraints as well as its community’s demographics, economic conditions, and credit needs and opportunities. Regulatory revisions that do not contemplate evaluating CRA performance in context could arguably undermine the CRA’s greatest attribute-- its recognition that banks are uniquely situated to be responsive to the most important community and economic development needs in their communities.

The typical small community bank focuses on serving its community through deposit and credit products and may not have the capacity to finance a major community development

initiative. But as banks grow in size or specialize in different types of lending, they may have greater capacity to invest through additional channels. We should be sensitive to the ways in which a bank's business model, in addition to its size, influences the types of activities it undertakes to meet its CRA obligations. We will want to maintain the flexibility to ensure that, no matter the business line, a bank can meet its CRA obligation by doing what it has the expertise to do well. And as we look to improve our CRA evaluations, the agencies will need to determine what kind of data will be necessary to evaluate a bank's CRA performance based on the activities it chooses and which banks should collect and report that data based on their scale and business model.

### **Consistency and Predictability**

The fourth principle is that the revised regulations should promote greater consistency and predictability in evaluations and ratings, both within and across the agencies. The members of our Federal Advisory Council have recommended that the regulations "need to be consistent across the [a]gencies and provide for all regulated financial institutions to be subject to the same CRA 'crediting', examination, and remedial standards."<sup>14</sup> Banks have expressed understandable concern regarding the variation they see in evaluations. Banks seek greater clarity in advance about what activities will qualify for CRA consideration. They want to understand how the qualitative criteria--those measuring the impact and responsiveness of loans, investments, and services--will be factored into their ratings.

This concern is not limited to banks. The community organizations and local governments that are trying to attract bank financing to their projects need this clarity, too. Regulatory streamlining can help to promote consistency, as would regular examiner training.

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<sup>14</sup> Federal Reserve Board Federal Advisory Council, Record of Meeting, May 2018.

## **Fair Credit Access**

The fifth and final principle for CRA modernization is to ensure that revised CRA regulations support its position as one of several mutually reinforcing laws designed to promote an inclusive financial services industry. The central thrust of the CRA is to encourage banks to ensure that all creditworthy borrowers have fair access to credit. For banks to be successful in meeting the credit needs of their entire community, it follows that they must guard against discriminatory or unfair and deceptive lending practices. Ensuring fair access to credit is difficult and requires ongoing vigilance.<sup>15</sup> For this reason, taking a holistic view of closely related issues is likely to be the best way to fulfill the purpose of the CRA, as one of several important laws intended to promote fair financial access.

## **Affordable Housing and the CRA**

I want to briefly connect the dots between the high priority we put on strengthening the CRA and the pressing challenge of affordable housing that is a key focus of the work that you all do. Access to affordable housing connects families concretely to place and can be a source of strength or fragility. Pew just released a study showing that 38 percent of renter households in America are spending more than 30 percent of their pretax income on rent, representing a 19 percent increase from 2001.<sup>16</sup> The percent of renter households that are spending half or more of their pretax income on housing increased by 42 percent during the same period.

Households that spend a high fraction of their income on rent often may find themselves unable to pursue proven strategies to achieve financial security and invest in their family's

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<sup>15</sup> Richard Rothstein, *The Color of Law: The Forgotten History of How Our Government Segregated America* (New York: W.W. Norton & Company, 2017).

<sup>16</sup> See <http://www.pewtrusts.org/en/research-and-analysis/reports/2018/04/american-families-face-a-growing-rent-burden>.

future. They may need to turn to costly short-term sources of credit to cover emergency expenses. Some may experience eviction if there is an unexpected expense or loss of income.

To manage the high cost of housing, workers may be compelled to live far from where they work, rent substandard units, or resort to overcrowding. Research shows that households that live far from work often pay a large share of their budget in commuting costs.<sup>17</sup> As a society, we need to do better in ensuring that affordable housing is available where it is needed.

The supply of affordable housing is a good example of a problem of national scope whose solution must be tailored to local needs and economic conditions. This audience knows better than most about the complex dynamics that affect housing at the local level. Local decisions on land use, zoning, taxes, and leveraging of federal funding, and whether community needs are prioritized, are at the heart of whether neighborhoods thrive.

I'm not going to suggest that there are any easy answers to housing affordability. Still, the CRA is one of the important policy levers that can make a difference by encouraging solutions that are tailored to local needs and circumstances. It does this by encouraging banks to provide affordable and sustainable mortgage products to qualified low- and moderate-income families. This helps those families have a chance to purchase homes sustainably and build equity. In addition, by encouraging banks to work with the community to identify tailored rental and homeownership investment opportunities, the CRA helps encourage the construction of affordable housing where it is needed most.

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<sup>17</sup> See, for example, the Center for Neighborhood Technology's Housing and Transportation (H+T) Affordability Index at <https://htaindex.cnt.org/about/>.

## **The Path Forward**

In our effort to refresh the CRA regulations, we will continue to honor the purpose of the CRA by encouraging banks to engage in local community and economic development initiatives. I am confident that there are ways to update the areas where we evaluate a bank's CRA performance without losing the core focus on place. We should do more to encourage banks to offer deposit and credit products designed to help rent-burdened customers save for homeownership and build strong credit scores that will enable them to succeed in obtaining mortgage credit on favorable terms. We should do more to encourage banks to lend to the underserved entrepreneurs and small businesses that hold the promise of providing jobs and growing local economies. Even as the economy looks strong overall, significant challenges remain for low- and moderate-income areas, making the CRA and its focus on local credit needs more important than ever. I look forward to hearing from you over the next several months to help inform our interagency effort to refresh the CRA regulations.

This conference is an opportunity for ANHD members to envision the future for New York's neighborhoods and discuss critical actions to achieve that vision. I know you have a full agenda today, replete with pressing conversations on the compelling challenges that face your neighborhoods. I want to applaud your work to ensure that all of New York's neighborhoods are communities of opportunity. Thank you.